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Report to the Joint Committee on Taxation

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TAX ADMINISTRATION

Investigating Illegal Income—Success Uncertain, Improvements Needed

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The Honorable Lloyd Bentsen
Chairman, Joint Committee on Taxation

The Honorable Dan Rostenkowski
Vice Chairman, Joint Committee on Taxation
Congress of the United States

This report responds to your request that we review the Internal Revenue Service's (IRS) Special Enforcement Program, which is IRS' primary vehicle for addressing the illegal income of organized crime figures and drug traffickers. You asked that we identify (1) the law enforcement results and tax revenues generated from program operations and (2) management improvements that could enhance program operations.

As arranged with the Committee, we are concurrently sending copies of this report to the Commissioner of Internal Revenue, the Attorney General, and other interested parties. We will make copies available to others upon request.

Richard L. Fogel

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Assistant Comptroller General

Executive Summary

Purpose

The Internal Revenue Service (IRS) has a Special Enforcement Program within the Criminal Investigation Division to investigate tax law violations and identify potential taxable income related to illegal activities. The program is designed to seek prosecution of those engaged in illegal activities and help tax the proceeds of these activities, making them less profitable.

The Joint Committee on Taxation asked GAO to review the Special Enforcement Program and identify (1) the law enforcement results and tax revenues generated from program operations and (2) management improvements that could enhance program operations.

Background

The Special Enforcement Program's primary objective is to investigate and seek criminal prosecution of major criminals—mainly important drug traffickers and organized crime figures—who violate the tax laws. IRS expects the program to not only punish the offender through a jail sentence or criminal fine, but also to have an unquantifiable deterrent effect on potentially noncompliant taxpayers.

The program is also expected to identify potential taxable income related to illegal activities and to refer closed criminal cases to the appropriate IRS components for tax assessment and collection. IRS' most recent estimate is that for tax year 1981, three illegal activities—drug trafficking, gambling, and prostitution—accounted for $34 billion in unreported income, or about $9 billion in unpaid taxes. It is not clear how much of this amount the program could realistically be expected to identify for tax assessment and collection because (1) identifying income from illegal activities is difficult and (2) other agencies are now empowered to seize assets related to organized crime, which can leave little or nothing to satisfy a tax liability.

In fiscal year 1985, Criminal Investigation completed 2,364 Special Enforcement Program investigations. About half of these investigations, which took about 71 percent of the program's investigative time, were part of multiagency cases in which IRS investigates a target usually selected by another agency. In addition to investigating a potential tax law violation, IRS can provide financial expertise to assist with other agencies' investigations or help identify assets for possible seizure. The other half were independent investigations that were worked solely by IRS personnel. About 93 percent of multiagency investigations and 42 percent of independent investigations were done under the auspices of a grand jury. (See p. 15.) The grand jury can enhance law enforcement

efforts by providing IRS special agents with expanded investigative powers, such as subpoena power. However, the grand jury procedure can hamper tax administration efforts because secrecy provisions generally prohibit access to grand jury information for subsequent civil action.

In considering the information that GAO presents on the Special Enforcement Program, it should be recognized that much of what this program does in multiagency investigations is in support of other law enforcement agencies. Because of the lack of readily available data, GAO did not assess the extent and value of the program's assistance to these agencies.

Results in Brief

IRS did more Special Enforcement Program investigations and generated more convictions in 1985 than in 1982. For cases closed during fiscal year 1985, GAO projects that about half resulted in a conviction, about two-thirds of those convicted received a jail sentence, and about one-third of those investigated were major criminals.

From a tax administration standpoint, GAO projects that the cases closed in fiscal year 1982—the latest year with complete data available—generated about $11 million in tax revenue, of which about $2 million represented taxes on illegal income.

Because specific goals or any other evaluation criteria have not been established, GAO cannot conclude whether these results meet the Congress' or IRS' expectations for a successful program.

GAO identified three management improvements that could enhance program operations: more complete and reliable management information; better guidance for working with grand jury information; and a district office program to monitor civil action on closed criminal cases.

Principal Findings

Law Enforcement Results

IRS statistics indicate that since 1980, the Special Enforcement Program's indictments and convictions increased about fourfold. GAO's analysis of nationwide samples of criminal cases closed in fiscal year 1985 revealed the following law enforcement results:

- 47 percent resulted in a tax-related conviction, compared to 23 percent for cases closed in 1982. The better results are largely attributable to IRS' increased participation in multiagency cases. (See pp. 13 to 15.)
- 42 percent of tax-related convictions resulted in a jail sentence of more than 1 year, 26 percent resulted in a jail sentence of 1 to 12 months, and 32 percent resulted in no jail sentence. (See p. 16.)
- 19 percent of tax-related convictions resulted in a criminal fine of over $5,000, 23 percent resulted in a criminal fine of $1 to $5,000, and 58 percent resulted in no criminal fine. (See p. 18.)
- 38 percent of those investigated were major criminals. (See p. 20.)

Tax Administration Results

Criminal Investigation referred 55 percent of the cases closed in 1985 and 64 percent of the cases closed in 1982 to the Examination Division for tax assessment. Of the cases closed in 1982, which was the latest year with complete tax information available, Examination made a tax assessment on 50 percent of cases referred; and IRS collected about $11.2 million of the $37.6 million assessed in taxes, interest, and penalties. About $2.2 million was collected from the tax on illegal source income. (See pp. 21 to 24.)

Better Management Information Could Improve Program Oversight and Evaluation

Management information relating to key program objectives, such as investigating major criminals and pursuing tax revenues from completed cases, is not available. Also, 76 percent of 509 cases GAO reviewed contained inaccurate or incomplete management information. Inaccurate information has resulted in erroneous and misleading reports to IRS management, Congress, and the public. With better information, IRS management would have a more complete picture of progress made toward key law enforcement and tax administration objectives. (See pp. 24 to 28.)

Better Guidance for Working With Grand Jury Information Could Increase Referrals

IRS' guidance on what constitutes grand jury information is not always clear. IRS officials in different locations are inconsistent in interpreting what constitutes grand jury information. Unclear guidance could have resulted in referable cases not being forwarded to Examination for tax assessment. Better guidance could help assure that potential tax revenues from these cases are pursued. (See pp. 28 to 30.)

More Can Be Done to Pursue Potential Tax Revenues

IRS could take steps to more actively pursue tax revenues from closed criminal cases. GAO found that Criminal Investigation did not forward 443 of 1,013 prosecuted grand jury cases closed in 1985 to Examination for possible tax assessment, thus foregoing potential civil action. GAO also found that Examination took an average of 14 months to assess taxes in sample cases closed in 1982, thus giving taxpayers an opportunity to dissipate assets and conceal income. Further, the Collection Division did not review Criminal Investigation information as required in 3 of 14 sample cases, and no documentation exists to show it had in the other 11 cases, before declaring about $1.3 million in tax assessments as currently uncollectible. One IRS district attempted to do more in this area by establishing a program to better monitor actions taken on closed criminal cases. IRS data indicate that this program has contributed to increased tax collections. (See pp. 30 to 34.)

Recommendations

To improve the management of Special Enforcement Program operations, GAO recommends that the Commissioner of Internal Revenue (1) improve the quality of management information; (2) provide better guidance on working with grand jury information; and (3) establish a program for monitoring IRS civil actions on closed criminal cases. (See p. 35.)

Agency Comments

IRS agreed with GAO's recommendations and is taking various actions to implement them. The Department of Justice had no comments on this report. (See pp. 35 to 37.)

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Abbreviations

CID	Criminal Investigation Division
CM&TRS	Case Management and Time Reporting System
GAO	General Accounting Office
IRS	Internal Revenue Service
SEP	Special Enforcement Program

Chapter 1

Introduction

The Internal Revenue Service (IRS) has a Special Enforcement Program (SEP) within the Criminal Investigation Division (CID) to investigate tax law violations and identify potential taxable income related to illegal activities. SEP is designed to seek prosecution of those engaged in illegal activities and help tax the proceeds of these activities, making them less profitable.

The Commissioner of Internal Revenue testified before the Senate Committee on Governmental Affairs in 1979 that drug trafficking alone generates billions of dollars in income, but only a "minuscule" amount is reported for Federal income tax purposes. Recognizing the seriousness of this and similar tax evasion problems, IRS designated SEP as the vehicle to identify and investigate the illegal income of organized crime figures, high-level drug traffickers, and other types of racketeers. At the request of the Joint Committee on Taxation, we reviewed SEP results and operations.

SEP Objectives and Operations

The primary objective of SEP is to investigate and seek criminal prosecution of major criminals—mainly important drug traffickers and organized crime figures—who derive substantial income from illegal activities and violate the tax laws. IRS officials believe that criminal sanctions provided by tax laws, such as jail sentences, fines, and other penalties, not only punish the offender but also have an unquantifiable deterrent effect on potentially noncompliant taxpayers.

For many years, public officials and law enforcement officers viewed the tax laws as useful tools that could be applied to areas of criminal activity which were difficult to detect and prosecute using traditional law enforcement methods. In the 1930s, Al Capone and a number of other criminals were convicted of tax law violations when standard methods of law enforcement were unsuccessful. In the 1960s and 1970s, various Administrations and Congress promoted the use of IRS as a law enforcement tool to investigate the financial aspects of crime and tax the substantial profits from criminal activities. Most recently, IRS was asked to use its unique role and abilities to attack the financial empires of major drug traffickers.

SEP is also expected to identify taxable income from illegal activities and refer closed criminal cases to the proper IRS component for tax assessment and collection. In this way, the program helps to tax the income from illegal activities, thus making such activities less profitable. IRS' most recent estimate is that for tax year 1981, three illegal activities—

drug trafficking, gambling, and prostitution—accounted for $34 billion in unreported income. Unpaid taxes on these illegal activities would have totaled about $9 billion—about $6 billion from drug trafficking, about $2 billion from prostitution, and about $1 billion from gambling. IRS officials believe that if complete information regarding these and other types of illegal activities were available, these amounts would be considerably higher.

Although income from illegal activities is taxable, it is unclear how much SEP could realistically be expected to identify for tax assessment and collection. By their very nature illegal activities are concealed, and identifying income from these activities for tax purposes is difficult. Also, in recent years other agencies have been empowered to seize assets related to major criminal activities. When assets are seized by other agencies and forfeited to the government as a result of a conviction, the target of the investigation can be left with little or nothing to satisfy a tax liability.

For fiscal year 1987, CID had an authorized budget of $231.7 million and expended about 4,071 staff years (about 2,712 special agent and 1,359 administrative staff years) which were allocated among the national office, 7 regional offices, 63 district offices, and 10 service centers. Although the percentage varied from location to location, in fiscal years 1983 through 1986 CID devoted about 48 percent of its total staff years to SEP investigations. The remaining resources were devoted to the General Enforcement Program, which addresses tax violations related to income earned through legal activities.

SEP investigations involve tax and tax-related violations of Title 26, Title 18, or Title 31 of the United States Code. Title 26 violations are the most directly tax-related and include such crimes as tax evasion, failure to file a tax return, and filing a false tax return. For SEP cases closed in 1985, about 81 percent[1] involved allegations relating to Title 26. Title 18 violations usually involve a tax-related conspiracy, such as conspiracy to defraud the United States and making a false, fictitious, or fraudulent written or oral statement. Title 31 violations are generally related to money laundering, such as the failure to file currency transaction reports.

[1]Our estimates for this report are based on samples of SEP cases closed during fiscal years 1982 and 1985. Appendix II provides a detailed description of our sampling methodology.

In fiscal year 1985, CID completed 2,364 SEP investigations. About 42 percent of these investigations were conducted solely by CID personnel, which we refer to in this report as independent investigations or cases. These investigations took about 26 percent of total SEP investigative time. Of the independent cases completed during 1985, about 28 percent involved allegations related to drug trafficking, 24 percent involved allegations of illegal gambling, and the remainder involved various alleged activities such as fraud or theft.

SEP investigations are also conducted as part of multiagency cases in which other agencies, such as the Federal Bureau of Investigation or the Drug Enforcement Administration, also devote investigative resources. SEP multiagency cases, which have increased significantly in the 1980s, accounted for 51 percent of the 1985 SEP caseload and took about 71 percent of SEP investigative time.[2] Of the multiagency cases completed during 1985, about 63 percent involved an allegation related to drug trafficking. The remainder involved various allegations, such as public corruption or fraud. In addition to investigating tax law violations, SEP special agents can also provide financial assistance to other law enforcement agencies.

Once all investigative action is completed and the criminal case outcome is known (for example, the case is discontinued for lack of criminal evidence, the case is declined for criminal prosecution as a result of a legal review, or the Department of Justice completes court action), the CID District Chief is responsible for referring the case and related case documents to the Examination Division for civil tax assessment, if appropriate. If the Examination Division makes a tax assessment, the case should be forwarded to the service center and, if necessary, to the Collection Division for tax collection.

Objectives, Scope, and Methodology

The Joint Committee on Taxation asked us to identify (1) the law enforcement results and tax revenues generated from SEP operations and (2) IRS actions that could improve the management of SEP operations.

To respond to the Joint Committee's request, we (1) held discussions with IRS officials (CID, Examination Division, Collection Division, and Office of Chief Counsel), Department of Justice officials (Tax Division,

[2]We could not determine whether 7 percent of the caseload, which took 3 percent of investigative time, was independent or multiagency cases. These were grand jury cases not prosecuted. CID officials in two IRS district offices believed that disclosing whether another agency was involved would violate grand jury secrecy provisions.

Executive Office for U.S. Attorneys, and various assistant U.S. attorneys responsible for tax cases), and officials from the U.S. courts; (2) reviewed records, case files, transcripts, memoranda, studies, and correspondence from IRS, the Department of Justice, and the courts regarding taxpayers who were targets of SEP investigations; and (3) performed a reliability assessment of selected information in CID's management information system.

We did detailed work at IRS' national office, three regional offices (Midwest, North Atlantic, and Southeast), and eight district offices (Atlanta, Buffalo, Chicago, Jacksonville, Manhattan, Providence, St. Louis, and Wichita). These eight districts were selected for detailed review in a sampling plan based on the number of SEP cases closed in each of the 63 IRS districts in operation during fiscal years 1982 and 1985.[3] For the purposes of our review, we considered a SEP case to be closed when all CID investigative work was finished and a criminal outcome was known. We then selected SEP cases closed in fiscal years 1982 and 1985. We randomly selected a sample of closed SEP cases in three of the eight districts (Chicago, Jacksonville, and Manhattan) because of the large size of the SEP caseload in those districts. We analyzed all closed SEP cases in the other five districts. Our methodology makes the results of our sample projectable to the nationwide universe of SEP cases. Consequently, the figures used in this report relate to the universe of SEP cases unless otherwise noted. We did not attempt to verify IRS' 1981 tax gap estimate of $9 billion for the illegal source income area or project it to subsequent years. Appendix I shows the organizations and locations where our work was performed. Appendix II includes a detailed description of our sampling methodology.

We selected fiscal years 1985 and 1982 for our study because IRS officials said these years would provide the most current data for analyzing SEP law enforcement and tax administration results. Fiscal year 1985 data were the latest complete fiscal year data available when we started our review. We reviewed 376 of 2,364 cases closed during fiscal year 1985 to obtain the most current data available on the law enforcement results and the referral of closed criminal cases for tax assessment and collection. Because IRS officials said it typically takes about 3 years to complete all tax assessment and collection activities on closed SEP cases, the most current tax collection data available when we started our work

[3]In 1986, IRS created a district office in Fort Lauderdale to oversee IRS operations in southern Florida. Before that time, all IRS operations in Florida were the responsibility of the Jacksonville District Office.

were for cases closed during 1982. Therefore, we reviewed 344 of 2,100 cases closed during fiscal year 1982 primarily to obtain the most current data available on how much tax was assessed and collected on closed SEP cases. We also used the 1982 sample as a baseline for our analysis of law enforcement results. CID officials said there was nothing atypical about these fiscal years and that they are generally reflective of SEP operations.

We gathered information relating to sampled cases from IRS' Criminal Investigation, Examination, and Collection Divisions; the Department of Justice; and U.S. District Courts using a structured collection instrument to assure consistent data for all cases. When we found conflicting information, we used the data we believed most reliable based on all available evidence. For grand jury cases in our samples, we could not gather some information firsthand because of grand jury secrecy provisions. For those cases, CID special agents provided allowable information on pro forma case information sheets. We could not verify the accuracy of the information provided by the special agents. Also, because of the lack of readily available data, we did not assess the extent or value of the program assistance provided to other agencies on multiagency cases.

IRS does not maintain statistics on the referral of closed criminal cases for tax assessment or the tax revenues generated from CID programs. We developed this information using IRS master file transcripts and CID, Examination Division, and Collection Division records. We attributed all tax assessments and collections to CID even though tax assessments and collections might have been made in some cases without CID involvement. For example, a tax assessment might well have been made regardless of CID involvement for the 15 percent of closed SEP cases that was originally referred to CID by the Examination Division.

We did our audit work between February 1986 and August 1987 in accordance with generally accepted government auditing standards.

SEP Success in Meeting Law Enforcement and Tax Administration Objectives Is Uncertain

From a law enforcement perspective, SEP activity in recent years has increased. Since 1980, SEP efforts have resulted in fewer discontinued investigations, more indictments and informations,[1] and more convictions. Of the SEP cases closed in fiscal year 1985, 47 percent resulted in a conviction; 68 percent of these convictions resulted in a jail sentence; 42 percent of the convictions resulted in a criminal fine; and 38 percent of those investigated were major criminals as defined by IRS or other agencies.

From a tax administration perspective, CID referred 55 percent of the SEP cases closed in 1985 and 64 percent of the SEP cases closed in 1982 to the Examination Division for tax assessment. Of the cases closed in 1982 and referred to the Examination Division, a tax assessment was made on 50 percent of the cases referred and IRS collected about $11.2 million of the $37.6 million assessed in taxes, interest, and penalties. About $2.2 million of the amount collected represented taxes on illegal income.

Because neither specific goals nor any other evaluation criteria have been established for SEP, we cannot conclude whether these results meet Congress' or IRS' expectations for a successful program.

SEP Convictions Have Increased

CID management information indicates that SEP's overall law enforcement results have improved in recent years, particularly with respect to the number of convictions. Table 2.1 shows that since 1980, SEP efforts have resulted in fewer discontinued investigations, more indictments and informations, and more convictions.

Table 2.1: Selected SEP Law Enforcement Statistics for Fiscal Years 1980 Through 1985

	Fiscal Years					
Category	**1980**	**1981**	**1982**	**1983**	**1984**	**1985**
SEP staff years	830	1,191	1,205	1,249	1,349	1,344
Cases initiated	1,414	1,907	2,075	2,009	2,104	2,458
Cases discontinued	770	741	1,084	901	833	752
Indictments and Informations	303	442	682	757	1,014	1,215
Convictions	257	323	555	551	816	927

Source: CID

Our analysis of nationwide samples also showed that these SEP law enforcement results have improved. For example, 47 percent of the SEP

[1] An indictment is the formal charging of the defendant with a particular crime by a grand jury. An information is also a formal charging but brought by the U.S. Attorney rather than by a grand jury.

cases closed in fiscal year 1985 resulted in a conviction compared to 23 percent of the SEP cases closed in fiscal year 1982. CID's management information system did not provide the data we needed to determine why these results improved. Also, we found that CID management information was not always accurate and was sometimes misleading (see pp. 24 to 28). Therefore, we obtained law enforcement information from a variety of sources, including CID, Department of Justice, and U.S. District Court files. Our analysis of this information showed that CID's increased involvement in multiagency cases was a major factor in achieving better overall law enforcement results. For fiscal year 1982, 32 percent of the SEP caseload were multiagency cases. For fiscal year 1985, 51 percent were multiagency cases. Multiagency cases yielded better results than independent cases, although both types of cases showed improved law enforcement results between 1982 and 1985.

Since the early 1960s, Congress and various Administrations have encouraged IRS to become involved in the total federal law enforcement effort against various types of organized crime. IRS and U.S. attorney representatives told us that CID was asked to participate in multiagency efforts so the tax laws could be used to attack the financial aspects of crime and to increase the likelihood that major criminals would be put in jail. Since 1980, CID has become heavily involved with various drug task forces, and the level of SEP effort devoted to multiagency cases has increased accordingly.

In multiagency investigations, CID generally develops the tax-related cases and manages its special agents the same way it does for its independent investigations. However, multiagency cases are different than independent cases in two ways. First, other federal agencies usually select the targets for multiagency investigations. In some cases, a target is already being investigated before CID is asked to participate. CID usually enters multiagency cases at the request of the U.S. Attorney or another agency to investigate potential tax-related violations and provide financial expertise. The various agencies involved in a multiagency case can share information and develop a coordinated investigative strategy.

Second, multiagency investigations are generally conducted under the auspices of a grand jury. The grand jury can provide special agents with expanded investigative powers, such as the power to subpoena, that are helpful in developing the case. Also, with the grand jury procedure, the Assistant U.S. Attorney or Department of Justice attorney is involved in the investigation and can help direct the investigative efforts to areas

that would be most productive for a successful prosecution. About 83 percent of multiagency cases completed in 1982 and 93 percent of those completed in 1985 involved a grand jury.

Our analysis of cases closed in 1982 and 1985 showed that the law enforcement results achieved on multiagency cases were better in 1985. For multiagency cases closed during 1982, about 53 percent were discontinued and about 29 percent resulted in a conviction. For multiagency cases closed in 1985, about 21 percent were discontinued and about 66 percent resulted in a conviction. For both fiscal years, the remaining cases were declined for prosecution or resulted in an acquittal.

Independent investigations are different than multiagency investigations in that they are not a part of a coordinated federal law enforcement approach and do not routinely use the grand jury procedure. Independent investigations usually begin with a CID lead or a referral from other IRS components, other government agencies, or the public. CID District Chiefs are responsible for selecting targets for investigation, reviewing completed cases, and recommending criminal prosecution to IRS Chief Counsel and the Department of Justice, if appropriate. About 16 percent of the independent cases closed in 1982 and 42 percent of those closed in 1985 involved a grand jury.

Although independent investigations did not result in as high a conviction rate as multiagency investigations, our analysis showed that independent investigations also resulted in fewer discontinued cases and more convictions in 1985 than in 1982. According to CID officials, the better results could be due to the increased use of the grand jury procedure. Also, in November 1979 CID changed its investigative strategy to work fewer cases that are more substantial and more likely to be successfully prosecuted. For independent cases closed during 1982, about 65 percent were discontinued and about 21 percent resulted in a conviction. For independent cases closed in 1985, about 55 percent were discontinued and about 30 percent resulted in a conviction. For both fiscal years, the remaining cases were declined for prosecution or resulted in an acquittal.

Although multiagency cases yielded better law enforcement results than independent cases, CID's overall responsibilities preclude it from devoting exclusive attention to multiagency investigations. CID devotes resources to independent investigations because many potentially noncompliant taxpayers would not likely be investigated by other federal law enforcement agencies.

Most SEP Convictions Resulted in a Jail Sentence

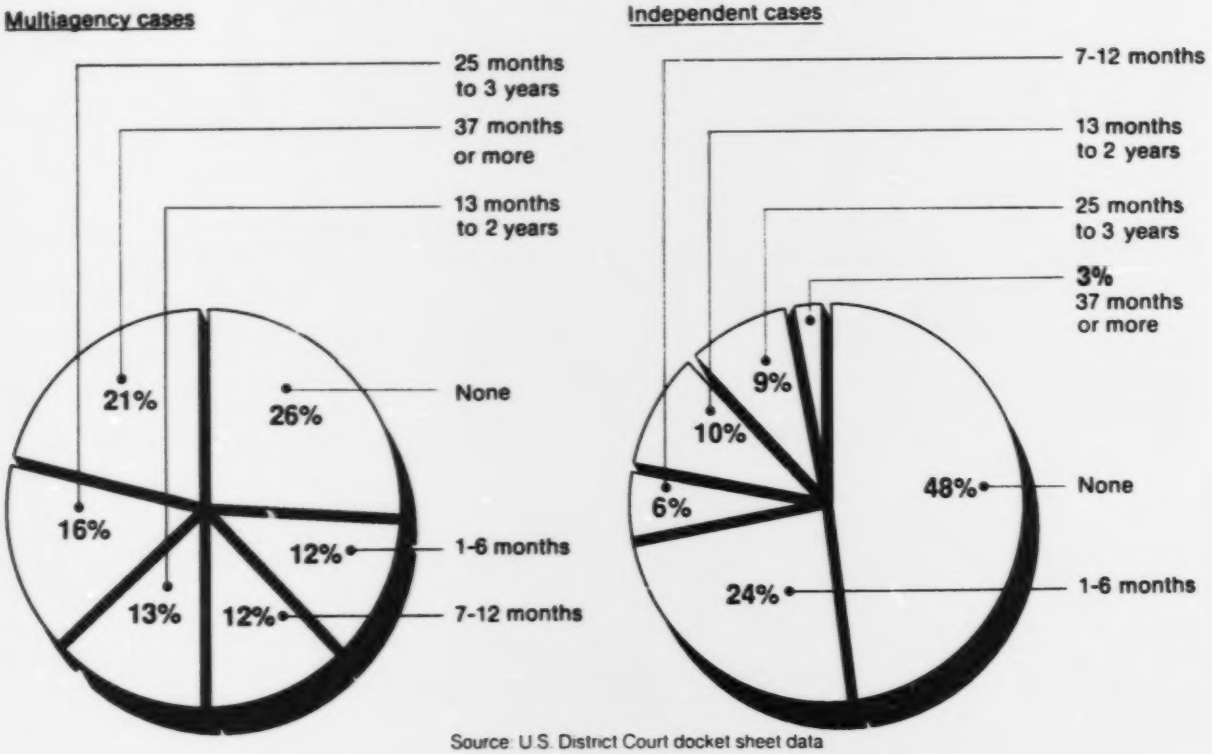
Our analysis of U.S. District Court files showed that 42 percent of SEP convictions in 1985 resulted in a jail sentence of more than 1 year; 26 percent resulted in a jail sentence of 1 to 12 months, and 32 percent resulted in no jail time. The duration of a jail sentence is not a factor under CID's control; rather it is a result of judicial discretion and penalties prescribed by law. Therefore, we did not compare these sentences to other sentences imposed for similar crimes. However, CID management considers sentence duration as an indicator of the seriousness of the offense, the importance of the criminal, and the deterrent value of the case.

In September 1987, the Department of Justice's Bureau of Justice Statistics reported[2] that the average sentence duration for all tax fraud convictions increased from 11 months to 21 months between 1980 and 1985. The Bureau of Justice Statistics also reported that 52 percent of those convicted of tax fraud were not sentenced to jail, and that 62 percent of those that were received a jail sentence of 1 year or less. The report's statistics on jail sentences resulting from tax fraud convictions included convictions related to both illegal and legal source income activities, and did not include all cases dealing with tax-related conspiracy and money laundering.

Our analysis of SEP cases closed in 1985 showed that the jail time imposed on multiagency cases differed from that imposed on independent cases. Figure 2.1 shows that for multiagency cases closed during 1985, 50 percent of SEP convictions resulted in a jail sentence of more than 1 year, 24 percent resulted in a jail sentence of 1 to 12 months, and 26 percent resulted in no jail sentence. In multiagency cases in our sample where jail time was imposed, the sentence averaged 32 months for the SEP conviction. The average jail sentence imposed on a nontax-related conviction in sample cases was 9 years and 5 months. In 35 percent of the multiagency cases where a sentence of more than 2 years was imposed on a SEP conviction, the corresponding sentence was to be served concurrently with a nontax-related sentence.

[2]"Federal Offenses and Offenders: White Collar Crimes," U.S. Department of Justice, Bureau of Justice Statistics, NCJ-106876, September 1987.

Figure 2.1: Jail Time Imposed on Tax-Related Convictions for Cases Closed During Fiscal Year 1985



Source: U.S. District Court docket sheet data

Figure 2.1 also shows that for independent cases closed during 1985, 22 percent of SEP convictions resulted in a jail sentence of more than 1 year, 30 percent resulted in a jail sentence of 1 to 12 months, and 48 percent resulted in no jail sentence. For independent cases in our sample where jail time was imposed, the sentence averaged 18 months for the SEP conviction. We did not determine whether the entire jail sentence imposed for either type of case was actually served.

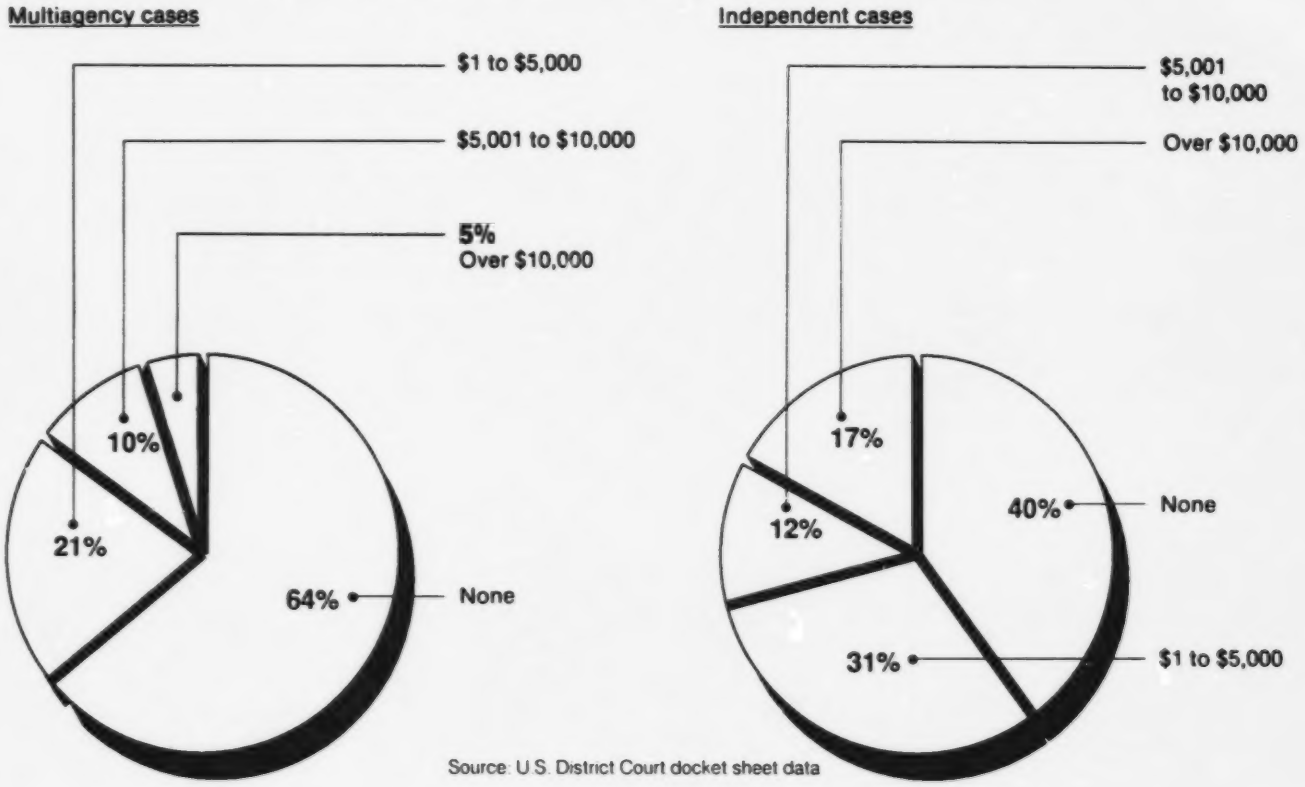
In April 1987, the United States Sentencing Commission issued a report[3] which proposed sentencing policies and practices for the federal criminal justice system. The report contains detailed guidelines for prescribing sentences for offenders convicted of federal crimes, including tax-related crimes. IRS officials said that the average sentence imposed for

[3]"Sentencing Guidelines and Policy Statements," U.S. Sentencing Commission, April 13, 1987.

SEP convictions would increase when these guidelines are implemented in November 1987.

Our analysis also showed that the majority of SEP convictions in 1985 did not result in a criminal fine. Overall, 19 percent of SEP convictions in 1985 resulted in a criminal fine of over $5,000, 23 percent resulted in a criminal fine of $1 to $5,000, and 58 percent resulted in no criminal fine. Figure 2.2 shows that 64 percent of the multiagency cases and 40 percent of the independent cases resulted in no criminal fine for the SEP conviction. We did not determine whether all fines imposed for both types of cases were actually paid.

Figure 2.2: Criminal Fines Imposed on Tax-Related Convictions for Cases Closed During Fiscal Year 1985



Source: U.S. District Court docket sheet data

Most SEP Cases Did Not Involve Major Criminals

A key SEP objective is to identify, investigate, and prosecute major criminals. CID management information on SEP cases did not indicate whether the targets under investigation were thought to be major criminals, and CID officials had no other statistical information along these lines. Our analysis of the 1982 and 1985 sample cases showed that most SEP cases did not involve major criminals as defined by IRS or other agencies.

Internal Revenue Manual section 9411 describes major crime figures as

> "persons who are reasonably believed to be engaged in organized criminal activities; notorious or powerful with respect to local criminal activities; receiving substantial income from illegal activities as a principal, a major subordinate, or an important aider or abettor; or infiltrating legitimate business through illegal means or infiltrating legitimate business through loaning or investing therein the proceeds from illegal activities."

Other law enforcement agencies also target and investigate similar types of major criminals.

Internal Revenue Manual section 9413 requires each CID district office to identify taxpayers residing in the geographic area that meet the IRS criteria. CID personnel are required to review these taxpayers' tax returns each year for possible criminal investigation. We found that two of eight districts we visited did not identify such taxpayers for the fiscal years we reviewed. For the other six districts we did not determine whether all tax returns were reviewed as required, nor did we assess the adequacy of any reviews. However, to determine the percentage of our sample cases that involved a major criminal, we asked special agents to denote whether the target of each SEP case was identified as a major criminal by IRS, a Department of Justice strike force, or the Drug Enforcement Administration at the time the case was opened. We could not verify the special agents' responses, because CID's files are updated periodically and old files had been purged prior to our review. We did not attempt to verify whether SEP targets were designated as major criminals by other agencies.

In addition to major criminals, CID management also emphasizes the importance of investigating taxpayers who are highly visible in the community and who allegedly violated tax laws. CID officials believe that publicity surrounding the prosecution of such taxpayers could have a deterrent effect for potentially noncompliant taxpayers. For example, the prosecution of a local businessman for underreporting income could

provide an unquantifiable deterrent effect and therefore promote overall compliance. Consequently, with special agent assistance, we also identified the SEP targets that were not major criminals but were highly visible members of the community.

Table 2.2 shows that, according to the recollections of the special agents, about 31 percent of the cases closed in 1982 involved a major criminal as defined by IRS or other agencies, and 66 percent did not. For cases closed in 1985, 38 percent involved a major criminal and 61 percent did not. Special agents could not recall whether 4 percent of the 1982 cases and 1 percent of the 1985 cases involved a major criminal.

Table 2.2: Targets of SEP Investigations Closed During Fiscal Years 1982 and 1985[a]

	Fiscal year 1982				Fiscal year 1985			
Type of target	**Multiagency**	**Independent**	**Total**	**Percent**	**Multiagency**	**Independent**	**Total**	**Percent**
Major criminal	368	230	598	31	589	243	832	38
Highly visible individuals	92	190	282	15	302	194	496	23
Not major criminal or highly visible	218	762	980	51	308	530	838	38
Cannot tell	0	74	74	4	6	22	28	1
Total	**678**	**1,256**	**1,934**	**100[b]**	**1,205**	**989**	**2,194**	**100**

[a]Does not include cases which we could not determine to be multiagency or independent

[b]Does not add to 100 percent due to rounding

Source: GAO estimates based on CID special agent information

About Half the Closed SEP Cases Were Referred for Civil Action

Our analysis of our 1985 sample showed that once criminal action was completed, CID referred about 55 percent of the cases for tax assessment or collection. In fiscal year 1982, about 64 percent of the closed SEP cases were referred. According to IRS officials, a major cause of the lower referral rate in 1985 was CID's increased involvement in grand jury investigations. Grand jury secrecy provisions prohibit access to information gathered under the auspices of a grand jury for civil use unless it is made public during criminal proceedings or an exception to the secrecy provision is granted by the court. Our work showed that special agents are not always sure what constitutes grand jury information and thus may be reluctant to forward a closed grand jury case to Examination if it could risk an illegal disclosure (see pp. 28 to 30). Table 2.3 shows that closed grand jury cases—particularly those that were not prosecuted—were far less likely to be referred for civil action.

Table 2.3: Types of SEP Cases Closed During Fiscal Years 1982 and 1985 That Were Referred for Tax Assessment or Collection

	Fiscal Year 1982			Fiscal year 1985		
Type of case	Total number	Number referred	Percent referred	Total number	Number referred	Percent referred
Nongrand jury:						
Prosecuted	255	127	50	202	176	87
Not prosecuted	951	847	89	459	408	89
Subtotal	**1,206**	**974**	**81**	**661**	**584**	**88**
Grand jury:						
Prosecuted	281	129	46	1,013	566	56
Not prosecuted	599	241	40	684	156	23
Subtotal	**880**	**370**	**42**	**1,697**	**722**	**43**
Total	**2,086**	**1,344**	**64**	**2,358**	**1,306**	**55**

Source: GAO estimates based on CID and Examination records.

Half of SEP Referrals Resulted in a Tax Assessment

Of the SEP cases closed during fiscal year 1982 and referred to the Examination Division for tax assessment, our analysis showed that tax assessments were made in about 50 percent of the cases—38 percent of the grand jury cases and 54 percent of the nongrand jury cases. For these cases, we project that Examination assessed about $37.6 million in taxes, interest, and penalties.[4] Of this amount, $9.4 million was assessed in 27 percent of cases that had been submitted to CID by Examination and thus might have been assessed without CID involvement. Similar data for our 1985 sample cases are not available because Examination action has not been completed for about 44 percent of the SEP cases referred.

Our analysis of CID's Special Agent Reports and Examination's Revenue Agent Reports showed that the resulting tax assessments were not always based on illegal source income. Of the $37.6 million assessed, $6.3 million, or 17 percent, was the tax assessed on income from illegal activities and $15.5 million, or 41 percent, was the tax assessed on income from legal activities. We could not determine whether $15.8 million, or 42 percent, was the tax on income from illegal or legal activities.

From discussions with IRS officials and our own analyses, we identified the following possible reasons for the level of tax assessments attributable to income from illegal activities:

[4]This figure represents net tax assessments. It does not include taxes, interest, and penalties abated by IRS.

- Illegal activities by their nature must be concealed, and quantifying the proceeds from such activities for tax purposes is very difficult. In some sample cases, IRS was unable to prove that the unreported income was from illegal sources because the targets of investigation had no records or laundered illegal source income through legitimate businesses.
- Many sample SEP cases were opened as a result of allegations that were never proven during the investigations. Our analysis shows that the allegation of illegal source income activity was proven in 15 percent of the 1982 cases and 29 percent of the 1985 cases. Although an initial allegation of illegal activity might not be proven, special agents sometimes find other alleged tax violations upon which to base a criminal case. The new alleged violations could involve legal source income. For example, when a drug trafficking allegation could not be proven, special agents based a criminal case on the taxpayer fraudulently underreporting income from his business.
- From a tax administration standpoint, CID may not be working the types of cases that generate tax revenues. Because of CID's increasing multiagency and grand jury work, fewer and fewer targets are actually being selected by CID for investigation. Although the targets selected by other agencies may be attractive from a law enforcement standpoint and may have an unquantifiable deterrent effect on taxpayer noncompliance, they may not be the ones most likely to generate tax revenues.

Most Tax Assessments Were Not Collected

Most of the taxes assessed by the Examination Division were not collected by IRS. Our analysis of our 1982 sample showed that IRS collected about $11.2 million, or 30 percent of the $37.6 million assessed. Of this amount, about $2.2 million represented taxes on illegal source income and about $6.6 million represented taxes on legal source income. We could not determine whether the remaining $2.3 million was the tax on illegal or legal income (amounts do not add due to rounding). At the time our work was completed, collection activity was still pending for 19 percent of the assessment cases with a collection potential of about $9.0 million.

From discussions with IRS officials and U.S. Attorney representatives and our own analyses, we identified the following possible reasons for the level of tax collections on these cases:

- An IRS study concluded that some taxpayers use the often lengthy period between the time the criminal case is completed and the tax is

assessed and collected to dissipate assets, conceal income, or place financial affairs beyond IRS detection. Consequently, the taxpayer appears to have few, if any, financial resources to satisfy a tax liability.

- IRS officials and U.S. attorney representatives said that a taxpayer's assets are sometimes seized by another agency in a multiagency case, leaving little or nothing to satisfy a tax liability.[5] In our sample of 1985 cases, 23 of 376, or about 6 percent, appeared to involve another agency seizing taxpayers' assets. We were unable to determine how many of these seizures resulted in forfeitures to the U.S. government because Department of Justice data we requested was unreliable. However, of these 23 cases, CID referred 13 for tax assessment and collection. IRS assessed a total of $3.7 million in taxes, interest, and penalties in 7 cases and, as of July 1986, collected partial payment in 4 cases totalling $129,850. Collection action on 3 cases was still pending when our review was completed.
- Collection officials said that some taxpayers investigated by CID simply do not have the financial resources to pay a substantial tax liability.

Conclusions

CID has increased its SEP activity in recent years. From a law enforcement perspective, our analysis showed that SEP efforts have resulted in more convictions in 1985 than 1982. About 68 percent of the convictions in 1985 resulted in a jail sentence and 42 percent resulted in a criminal fine. About 38 percent of the cases closed in 1985 involved a major criminal as defined by IRS or other agencies. From a tax administration perspective, SEP cases closed in fiscal year 1982 generated about $11.2 million in tax revenue, of which $2.2 million represented taxes on illegal source income.

Neither specific goals nor any other evaluation criteria for evaluating the program's law enforcement and tax administration results have been established. Consequently, we cannot conclude whether these results meet Congress' and IRS' expectations for a successful program.

[5]The Anti-Drug Abuse Act of 1986 (Public Law 99-570) granted IRS seizure authority for certain Title 31 money laundering offenses. Because this seizure authority became operational in 1987, its impact on tax assessments and collections is unknown. Title 31 cases represented about 6 percent of our 1985 sample.

IRS Could Improve the Management of SEP Operations

In addition to identifying SEP's law enforcement and tax administration results, we also identified several management improvements that could enhance SEP operations. These improvements include obtaining more complete and reliable management information for better program oversight and evaluation, developing better guidance for working with grand jury information that could increase case referrals for tax assessment, and establishing a district office program to monitor the closed criminal cases to assure that appropriate civil action is taken.

More Complete and Reliable Management Information Could Improve Program Oversight and Evaluation

Complete and reliable information for reflecting program results is key to effective program oversight and evaluation. Such information, coupled with evaluation criteria, would put IRS in a better position to identify program accomplishments and assess whether program objectives are being met. Our work showed that CID's management information system, known as the Case Management and Time Reporting System (CM&TRS), does not contain information related to key program objectives and that some information is inaccurate or misleading.

Important Program Information Is Not Available

CM&TRS does not provide some important information for monitoring and evaluating program operations. For example:

- The CM&TRS does not identify whether a case involves the investigation of a major criminal. Investigating such criminals is a SEP objective stated in the national office program guidelines (see app. III). Consequently, CID management relies mainly on case examples rather than on comprehensive information to monitor progress toward accomplishing this objective.
- The system does not show whether a case involved a highly visible target or generated widespread publicity. Investigating highly visible taxpayers and generating widespread publicity are also nationwide SEP objectives. CID management believes that publicity about the successful prosecution of a highly visible member of the community provides an unquantifiable deterrent effect. Without information relating to the types of taxpayers investigated and the publicity that resulted, CID management cannot easily monitor whether SEP efforts may have deterrent value.
- The system does not show whether the case was forwarded for tax assessment and collection. Also, neither CID nor IRS has an information system that identifies the amount of tax revenues generated by SEP

cases. Therefore, IRS management cannot determine to what extent SEP is generating tax revenues.

Without this information, CID management is not in the best position to monitor SEP operations and evaluate the effectiveness of the program in meeting its law enforcement and tax administration objectives.

CM&TRS Contains Inaccurate and Misleading Information

Internal Revenue Manual section 9570 requires CID personnel (special agents and administrative staff) to extract from case files various information items, such as the source of the case and the outcome of the investigation, and enter them on Form 4930. Form 4930 is the primary data source for CM&TRS reports. CID personnel are also required to update case information using Form 4930 when better data becomes available or when the status of the case changes.

We made a reliability assessment of selected CM&TRS information using IRS records and U.S. District Court files relating to 509 cases from our 1982 and 1985 samples. We did not perform an assessment for sample cases from the Southeast Region because the most recent Southeast Regional Office Review Program reports criticized the district offices for inaccurate CM&TRS data. For example, a 1986 report on the Jacksonville district disclosed that "the overall (management information) system failed to accurately reflect required investigative information."

Our review of the 509 cases showed that in 387 cases, or 76 percent, 1 or more Form 4930 information items was inaccurate and/or missing. Of these 387 cases, 210 had inaccurate Form 4930 information and 324 had missing Form 4930 information. Some inaccurate or missing information, such as the target's birthdate, would not be crucial to management decisionmaking or to the outcome of the case or any subsequent evaluation. However, table 3.1 shows inaccuracies and omissions we found relating to items that would affect program evaluation such as the duration of sentence imposed for the tax-related charge, the source of the case, the taxpayer identification number, and whether the case was investigated under the auspices of a grand jury.

Table 3.1: Management Information That Was Inaccurate or Omitted in Fiscal Year 1982 and 1985 Sample Cases

Item	Number of cases reviewed	Number of inaccuracies/ omissions	Percent of cases with inaccuracies/ omissions
Sentence duration	80[a]	28	35
Source of case	509	76	15
Taxpayer identification number	509	62	12
Grand jury designation	310[b]	34	11

[a]Analysis involved fiscal year 1985 sample cases where a jail sentence was imposed.

[b]Analysis involved only grand jury cases.

Source: GAO analysis

Another management information problem involves the categorization of cases. When SEP cases are opened, CID personnel describe the nature of a case on the Form 4930 using 1 of 4 program codes (organized criminal activities, wagering, strike force, and illegal income activities); an illegal activity code; and, if appropriate, 1 of 14 nationally coordinated project codes. The individuals who select codes on the basis of allegations of illegal activity often do not change the codes if the allegation is not proven. Therefore, statistics relating to the convictions resulting from cases categorized as drug trafficking and organized crime investigations can be misleading. IRS management, Congress, and the public could misinterpret this information when reviewing periodic and annual reports of CID activities in these areas. The following examples illustrate this coding problem. The examples are not intended to suggest that these investigations were conducted inappropriately.

- The brother of a convicted mobster was alleged to be conducting a photography business from his home without reporting income on his personal income tax return. The case outcome is listed with the organized crime program statistics.
- A farmer was alleged and found to have underreported his agricultural income. The taxpayer was not alleged to be an organized crime figure and the investigation disclosed no evidence along these lines. The case outcome is listed with the organized crime program statistics.
- The president and vice president of a small food processing business, who had no prior arrest records for narcotics, were alleged to be involved with drug trafficking. They were convicted of diverting corporate income to personal use. The indictments do not mention narcotics and no agency that investigates drug trafficking was involved in the investigations. The cases were coded as nationally coordinated narcotics

project cases and the convictions were reported with these narcotics statistics.

- The owner of an automobile dealership was alleged and found to have diverted corporate income to personal use. The taxpayer was not alleged to be an organized crime figure and the investigation disclosed no evidence along these lines. The case outcome is listed with the organized crime program statistics.

Although some types of inaccuracies and omissions could have a greater impact on program oversight and evaluation than others, inaccurate and misleading CM&TRS information has generated erroneous or misleading reports. For example, the Assistant Commissioner (Criminal Investigation) uses CM&TRS data to prepare briefing materials for various audiences, including Congress. The briefing materials for fiscal year 1985 showed that the average prison term imposed for a SEP conviction was 53 months. However, our review of U.S. District Court docket sheets for our 1985 sample cases disclosed that the average jail term imposed for a SEP conviction was 28 months. The difference could be due to several factors. We found in sample cases that CID personnel overstated or understated the duration of the tax-related sentence imposed. In other cases, CID personnel erroneously recorded jail time imposed on both the tax-related charge(s) and the nontax charge(s) developed by another agency. In still other cases, CID personnel followed the permissible practice of recording the jail sentence imposed on a nontax charge(s) developed by another agency when the tax-related charge(s) was dropped in plea bargaining. Internal Revenue Manual section 9570 permits this latter practice even though the nontax charge(s) can involve longer jail sentences than are possible for the tax-related charge(s).

Inaccuracies and omissions occurred mainly because CID personnel did not make accurate data entries or update case information as required by Internal Revenue Manual section 9570. Several CID officials said that the completeness and accuracy of data input is not a high priority among CID personnel. Various CID managers are aware that some Form 4930 information is not accurate. They noted that this problem is not new, and that the national office has issued several memorandums requesting that CID personnel exercise more care when entering data on the Form 4930 and that the data be updated when appropriate. Our work shows that the problem persists despite these efforts.

CID has a management information initiative underway known as the Automated Criminal Investigation. This initiative is expected to aid special agents in their use of data by providing an on-line capability for

inputting data and requesting reports. Over a 10-year period, IRS projects costs to be $107 million, about $20.5 million of which is equipment costs. Since it is still in the planning stages, this system could be designed to address the management information weaknesses in CM&TRS.

Better Guidance for Working With Grand Jury Information Could Increase Referrals for Tax Assessment

According to IRS and Department of Justice officials, what constitutes grand jury information is not always clear. CID officials in several districts we visited said the absence of adequate guidance for working with grand jury information hampers their maximizing the tax revenue potential of SEP cases and, to some degree, has contributed to the low referral rate for closed grand jury cases.

Two Supreme Court decisions in 1983, United States v. Baggot, 463 U.S. 476, 103 S. Ct. 3164 (1983) (Baggot), and United States v. Sells Engineering, Inc., 463 U.S. 418, 103 S. Ct. 3133 (1983) (Sells), restricted access to grand jury information in subsequent civil proceedings. The Baggot and Sells decisions tightened the standards under which a court order could be obtained for the disclosure of grand jury information, thereby reinforcing the historic policy of preserving the secrecy of the grand jury. IRS and Department of Justice officials told us that after the Baggot and Sells decisions, exceptions to grand jury secrecy restrictions, known as Rule 6(e) exceptions,[1] became harder to obtain. Consequently, IRS has become less willing to request Rule 6(e) exceptions. Whereas an IRS official said that a Rule 6(e) exception was often requested and obtained prior to the Baggot and Sells decisions, exceptions were requested on only three grand jury sample cases closed during 1985.

The Baggot and Sells decisions pose significant problems for IRS in assessing and collecting taxes on closed grand jury cases. Unless the grand jury information pertinent to the tax revenue aspects of the case is made a matter of public record through the indictment, plea agreement, or other court document, it generally cannot be obtained for use in a related subsequent civil case. Without access to key tax-related information, Examination may not be in a position to pursue tax assessments. IRS and U.S. Attorney representatives have had some success with including key tax-related information in indictments, plea agreements, and other public court documents. However, these efforts have been affected to some degree by IRS and Department of Justice concerns about

[1] Rule 6(e) codifies the traditional rule of grand jury secrecy by prohibiting members of the grand jury, government attorneys and their assistants, and other grand jury personnel from disclosing matters occurring before the grand jury except as otherwise authorized by the rule. Witnesses are not bound by the secrecy of the proceedings.

the appearance of using the grand jury procedure as a tool for subsequent civil action. The IRS Associate Commissioner (Operations) testified before the Senate Judiciary Committee in November 1985 that millions of dollars in potential assessments are being lost because of the restrictions imposed by the Baggot and Sells decisions.

We found that officials in different locations are inconsistent in interpreting what constitutes grand jury information. Internal Revenue Manual section 9267.3(5) states that "information disclosed to or developed by IRS personnel while assisting an attorney for the government in connection with a grand jury will generally (emphasis added) be considered to be grand jury information governed by the secrecy provisions of Rule 6(e)." CID officials in various locations use different standards for interpreting this guidance and determining what is grand jury information. The following examples illustrate this point.

- Since we did not have access to grand jury case files, we asked CID officials in eight IRS districts to provide general information relating to sampled cases, such as source of the case, whether another agency was involved, and whether a basis existed for a potential tax assessment. CID officials from six of eight districts provided this information. CID officials in the other two districts would not provide such information if the case did not result in an indictment, citing grand jury restrictions.
- A CID District Chief declined to provide documents from selected grand jury cases after he had directed his staff to remove or delete all grand jury information from the case files. He said that he could not recognize grand jury information because there were no specific criteria that defined what it was.

CID officials in several districts we visited identified the lack of clear IRS guidance for grand jury information as a major problem. Internal Revenue Manual section 9267.3(3) requires IRS employees to identify non-grand jury information in case files for possible use in tax assessment. Without clear guidance, special agents are not always sure what items can be forwarded to Examination without a Rule 6(e) exception. Rather than risk a criminal sanction that could result from the disclosure of restricted information, special agents sometimes classify most, if not all, case information as grand jury information.

Various IRS and U.S. attorney representatives said that IRS has generally taken a more conservative view than the Department of Justice concerning what constitutes grand jury information. According to IRS officials, IRS often restricts most, if not all, information developed by special

agents while working on a grand jury case. Generally, U.S. Attorneys and other law enforcement agencies consider subpoenaed testimony or documentation prepared for the grand jury as grand jury material. According to the former Assistant Commissioner (Criminal Investigation), IRS was more restrictive in this regard than is necessary, partially because it anticipated being able to obtain Rule 6(e) exceptions. This is no longer the case, and the failure to establish clear guidance could have resulted in special agents not forwarding referable grand jury cases to Examination for possible tax assessment.

IRS Chief Counsel representatives acknowledged that IRS has not published guidance for working with grand jury information. However, they said that special agents do not often seek Chief Counsel's assistance for determining what constitutes grand jury information. They said that it is not possible to create a universally acceptable definition for grand jury information because information-gathering techniques and circumstances can vary for each grand jury case. They believe that a two-step process could reduce uncertainty in this area. First, they said they could prepare better overall guidance on what constitutes grand jury information for the benefit of special agents. Second, because of the varying circumstances of each grand jury case, they also believe that special agents should consult with IRS Chief Counsel attorneys to help determine what information can be forwarded to other IRS components for possible use in civil action.

In our opinion, this two-step approach has merit. Not only would this approach reduce the uncertainty of special agents about what information could be forwarded to Examination, but also it would put IRS in a better position at the close of the criminal case to request needed documents from the court.

More Can Be Done to Pursue Potential Tax Revenues

In addition to resolving uncertainties about grand jury information, IRS could take other steps to actively pursue tax assessment and collection in closed criminal cases where appropriate. Our analysis shows that CID is not forwarding all referable cases; the time taken by Examination to assess taxes can make collection action difficult; and Collection declared some assessments as currently uncollectible before reviewing CID information or checking with CID as required.

One IRS district has designed and implemented a program to monitor civil actions taken on closed criminal cases which addresses these types of problems. Although we did not review this program, IRS statistics

show that after the program was implemented the percentage of tax collected for closed criminal cases increased significantly.

Potential Tax Revenues Are Not Always Pursued

Our analysis showed that CID is not forwarding all referable cases to Examination for tax assessment and collection when criminal action is completed. We project on the basis of our 1985 sample that 443 of 1,013 prosecuted grand jury cases, or 44 percent, were not referred to Examination. Internal Revenue Manual sections 9631.3 and 9662 require CID to refer closed criminal cases to Examination and Collection unless the Special Agent's Report does not relate "to matters within their normal jurisdiction."

We followed up on all 14 prosecuted grand jury cases in our 1985 sample from one district that were not referred to determine why. Seven of the 14 cases involved income tax violations, 4 involved wagering violations, and 3 involved violations related to money laundering. In 3 of the 14 cases, the plea agreement or probation order required the taxpayer to cooperate with IRS in completing any tax audit. CID officials gave the following reasons for not referring these 14 cases: (1) in the judgment of the special agent, not enough nongrand jury information was available for Examination to pursue an audit; (2) the primary focus of the criminal investigation was not on potential income tax violations; (3) in the judgment of the special agent, the amount of any potential assessment was too small for referral to Examination; and (4) the individual filed income tax returns during the criminal investigation.

We brought these 14 cases and available case information to the attention of district Examination officials. These officials said that in general, all prosecuted grand jury cases should be referred to Examination, especially the cases in which the criminal sentence requires cooperation with IRS in a tax audit. We also discussed these 14 cases with national office Examination officials. After reviewing the case information, they said that these 14 prosecuted grand jury cases should have been forwarded to Examination. Further, they said that all 443 prosecuted grand jury cases that were not referred should have been forwarded unless unusual circumstances existed. Although all referred cases might not result in audits and tax assessments, Examination officials said such cases should be forwarded so that tax audits can at least be considered.

We also found that the time taken by Examination to assess taxes can make collection action difficult. For our 1982 sample cases, an average of 14 months elapsed between the date the criminal case was closed and

the date a tax assessment was made. Examination officials said that the 14-month average was understandable because (1) audits of taxpayers investigated by CID are often difficult and time-consuming and (2) audits resulting from tax fraud investigations are not given a high priority in the Examination program letter. The time taken to complete tax audits has made tax collection more difficult in some cases. An IRS study concluded that some taxpayers have used this period to dissipate assets, conceal income, and place his or her financial affairs beyond IRS detection.

Also, because of the time taken to assess taxes, IRS may not be able to take advantage of the enforcement power of the U.S. courts when the plea agreement or judgment order stipulates that the defendant cooperate with IRS in a tax audit and pay all taxes due as a condition of probation. For example, an individual was convicted and sentenced to 3 years' probation and ordered to pay all back taxes as a condition of probation. According to the U.S. District Court probation officer, when the individual went to IRS, Examination personnel told him that the audit was not completed and IRS could accept no money until an assessment was made. This went on for the entire probation period, and the probation officer eventually told the court that the conditions of probation had not been met, but through no fault of the defendant. The court released the defendant from probation status. An Examination group manager in the district office responsible for the case said that a 3-year delay is not unusual and that Examination does not track such cases to assure timely action.

Our analysis also showed that Collection is not always taking required collection actions on closed SEP cases. Internal Revenue Manual section 5612.2 and subsequent revisions required Collection revenue officers to review the Special Agent's Report, if available, and/or attempt to contact CID before declaring an assessment as currently uncollectible when the tax assessment exceeded $2,000 and a fraud penalty was assessed. For 14 cases from our 1982 sample that met this criteria, we found that Collection did not review the Special Agent Reports or contact CID in 3 cases and found no documentation in Collection records to show that this was done in the remaining 11 cases. About $1.3 million in tax assessments was declared currently uncollectible in these 14 cases. While such contact would not necessarily result in additional tax collections, CID officials believe information in their possession could sometimes be beneficial. Targets of closed cases are sometimes involved in related or subsequent investigations, so CID may be aware of the taxpayer's whereabouts or the location of assets.

A Tracking Mechanism Has Improved Revenue Potential

As indicated in the previous section, better organizational controls are needed to assure that appropriate and timely action is pursued by all IRS components on closed criminal cases. In 1982, IRS' Birmingham District Office initiated a program known as the Birmingham Plan to identify significant and flagrant cases of noncompliance needing interdivisional coordination and to track these cases through IRS channels. According to the district director, the development of the program was prompted by a review in the Collection Division that disclosed that very little was being collected on tax judgments and that some large cases had been on record for long periods of time with no collection activity. Another major factor in its development was a review of closed CID cases that revealed as little as 10 cents on every dollar were being collected on tax assessments from criminal cases.

The Birmingham Plan established separate controls to monitor closed CID cases where a taxpayer was ordered by a court to pay the taxes owed and situations involving other taxpayers who may attempt to defeat IRS tax assessment and collection efforts. CID, Examination, and Collection each have responsibility for tracking cases they determine to be in need of interdivisional coordination and for assuring that appropriate civil action is taken as the cases flow through the various IRS channels. CID is responsible for tracking the cases through the IRS District Counsel, the Department of Justice, and the U.S. attorney's office; recommending that appropriate information is included in public court documents; recommending that specific actions be included in any plea agreement to protect the government's interest and ensure payment of any tax liability; and assuring that the cases are forwarded for tax assessment and collection. Examination and Collection are responsible for tracking these cases to assure that case movement through their components meets established critical time frames. The District Director monitors the results of this program.

The Birmingham Plan has also incorporated a records checking mechanism that enables IRS officials to keep track of the assets of noncompliant taxpayers and to locate assets that would have previously gone undetected. This mechanism includes such information as property records, listings of condominium owners, and currency transaction report violations. According to the District Director, this records checking mechanism is a major benefit because it makes hiding assets from the government more difficult for noncompliant taxpayers.

Although we did not evaluate the Birmingham Plan, IRS officials believe it has merit based on results to date. According to the District Director

and Chief of Collection, the current collection rate on tax assessments from criminal cases is close to 80 cents on every dollar. Also, with the program in place, IRS officials use the percentage of such tax assessments being collected as another indicator of CID performance.

We believe that a program to monitor civil actions on closed criminal cases could be very beneficial to IRS for several reasons. First, it could help assure that CID, Examination, and Collection take all appropriate civil actions on closed criminal cases. Second, it could help CID identify the types of cases that are attractive from a tax collection standpoint for targeting investigative resources. Third, it could help IRS management evaluate how well CID is addressing IRS' overall tax administration mission and helping to generate tax revenues.

According to the Birmingham District Director, this program has no features that make it uniquely suited for his district, and other districts could adopt the program with minor modifications to the software package. Recently, the Jacksonville District began implementation of a similar program and the Southeast Region formed a task force to study the feasibility of implementing the program regionwide.

Conclusions

We identified several management improvements that could be made to enhance SEP operations. First, more complete and reliable management information could improve program oversight and evaluation of progress toward important law enforcement and tax administration objectives. Information relating to key program objectives, such as investigating major criminals and pursuing tax revenues from completed cases, is not currently available. Also, other information that is available was sometimes inaccurate or misleading.

Second, better guidance on what constitutes grand jury information could increase case referrals for possible tax assessment. Currently, IRS officials in different locations are inconsistent in interpreting what constitutes grand jury information. Unclear guidance appears to have resulted in referable cases not being forwarded to Examination for tax assessment.

Lastly, IRS could take steps to more actively pursue tax revenues from closed criminal cases. Currently, CID is not forwarding all referable cases, the time taken by Examination to assess taxes can make collection action difficult, and Collection is declaring some assessments as currently uncollectible before reviewing CID information or checking with

CID as required. Seven of eight district offices we visited had no management system to assure interdivisional coordination and prompt civil action on closed criminal cases. One district has designed a tracking program for closed criminal cases that appears to have merit with regard to increasing tax collections.

Recommendations

To improve the management of SEP operations, we recommend that the Commissioner of Internal Revenue take the following actions:

- Collect management information relating to key program objectives such as investigating major criminals and referring closed cases for tax assessment or collection. Also, identify the tax revenues generated by SEP cases.
- Review existing CM&TRS input controls to determine how the accuracy of management information can be improved.
- Work with IRS Chief Counsel and Department of Justice representatives to provide better guidance for special agents on what constitutes grand jury information. Also, require special agents to consult with IRS Chief Counsel attorneys, or with U.S. attorney representatives if IRS Chief Counsel is not involved, at the close of a grand jury case to help determine what information could be forwarded to Examination for civil action.
- Establish a district office program to monitor the civil actions taken by various IRS components on closed criminal cases.

Agency Comments and Our Evaluation

IRS agreed with the above recommendations (see app. IV). It concurred with our findings that CM&TRS does not provide information relating to key program objectives, and that such information would improve CID's ability to monitor program operations. While IRS did not specify areas for improvement, it noted that top level CID officials are analyzing the CM&TRS to seek ways to more accurately reflect program efforts and results. We believe that to be most useful for managing and evaluating program operations, CM&TRS should include information on the achievement of the program objectives outlined in CID's national program letter. Further, because CID is part of our nation's tax administration agency, we believe CM&TRS should contain information relating to subsequent tax assessments and collections that result from closed criminal cases.

IRS concurred with our recommendation to review existing CM&TRS input controls to improve data accuracy. In the future, CID officials will

include a review of policies and procedures regarding CM&TRS data accuracy and input controls in national office and regional office evaluations. Also, the accuracy of CM&TRS data will be a priority issue in all operations reviews conducted by the heads of CID district offices. We believe that the implementation of these procedures should help improve the reliability of CM&TRS information.

IRS agreed with the premise that better guidelines for working with grand jury information could increase referrals for tax assessments. However, it noted that the definition of what constitutes grand jury information is not always clear and has resulted in conflicting judicial decisions, and therefore the development of comprehensive guidelines is a difficult task. IRS noted that in January 1984, the Department of Justice issued guidelines in this area, and since that time IRS has made pertinent updates to its Chief Counsel Directive Manual and offered advice and training to CID special agents on the parameters of grand jury restrictions. We acknowledge that preparing guidance in this area is a difficult task and that IRS and the Department of Justice have made some efforts along these lines. However, inconsistencies and uncertainty still exist regarding the classification and treatment of grand jury information. IRS' Office of Chief Counsel is now completely revising its Chief Counsel Directive Manual in this area, and is coordinating this effort with Department of Justice representatives to ensure that its guidance is consistent with the position of the Department of Justice for the government as a whole. Better guidance should help reduce inconsistencies and uncertainties regarding the subsequent civil use of information from closed grand jury cases.

With respect to consulting with the U.S. Attorney on what information could be used for civil action, IRS concurred that, in grand jury matters, CID special agents should confer with the appropriate U.S. Attorney to insure that all information applicable for civil purposes is made available to Examination personnel. In the near future, IRS will incorporate this into the criminal investigation portions of the Internal Revenue Manual.

IRS said our recommendation to establish a district program to monitor civil actions on closed criminal cases has a good deal of merit. It initiated a feasibility study of the district office program we identified and when the study is completed it will make a decision to implement this or a similar plan. We believe that implementing such a plan will be a major step in addressing the types of problems we identified in our review.

The Department of Justice was given an opportunity to provide comments because U.S. Attorneys and Tax Division officials furnished views and information which were used in our report. However, the Department of Justice had no comments on our findings or recommendations.

Organizations and Locations Visited During Our Review

Internal Revenue Service

National Office:

- Office of the Assistant Commissioner (Criminal Investigation)
- Office of the Assistant Commissioner (Examination)
- Office of the Assistant Commissioner (Collection)
- Office of the Associate Chief Counsel (Litigation), Criminal Tax and Tax Litigation Divisions

Regional offices:

- Midwest Region, Chicago, IL
- North Atlantic Region, New York, NY
- Southeast Region, Atlanta, GA

District offices:

- Atlanta, GA
- Birmingham, AL
- Buffalo, NY
- Chicago, IL
- Fort Lauderdale, FL
- Jacksonville, FL
- Manhattan, NY
- Providence, RI
- St. Louis, MO
- Wichita, KS

Department of Justice

- Tax Division, Washington, DC
- Executive Office for U.S. Attorneys, Washington, DC
- U.S. Attorney, Georgia Northern District, Atlanta, GA
- U.S. Attorney, Florida Southern District, Miami, FL
- U.S. Attorney, Illinois Northern District, Chicago, IL
- U.S. Attorney, Missouri Eastern District, St. Louis, MO
- U.S. Attorney, District of Kansas, Wichita, KS
- U.S. Attorney, New York Southern District, New York, NY
- U.S. Attorney, New York Western District, Buffalo, NY
- U.S. Attorney, District of Rhode Island, Providence, RI

United States District Courts

- Northern Judicial District of Georgia, Atlanta, GA
- Middle Judicial District of Georgia, Macon, GA
- Southern Judicial District of Georgia, Savannah, GA

- Northern Judicial District of Florida, Tallahassee, FL[1]
- Middle Judicial District of Florida, Jacksonville, FL; Orlando, FL; Tampa, FL
- Southern Judicial District of Florida, Fort Lauderdale, FL; Miami, FL; West Palm Beach, FL
- Southern Judicial District of New York, New York, NY
- Northern Judicial District of New York, Albany, NY[1]
- Eastern Judicial District of New York, Brooklyn, NY
- Western Judicial District of New York, Buffalo, NY
- Central Judicial District of California, Los Angeles, CA[1]
- Eastern Judicial District of Virginia, Alexandria, VA[1]
- Judicial District of Rhode Island, Providence, RI
- Northern Judicial District of Illinois, Chicago, IL
- Central Judicial District of Illinois, Springfield, IL[1]
- Southern Judicial District of Illinois, E. St. Louis, IL[1]
- Judicial District of Kansas, Wichita, KS
- Eastern Judicial District of Missouri, St. Louis, MO
- Western Judicial District of Missouri, Kansas City, MO[1]
- Judicial District of Nevada, Las Vegas, NV[1]
- Southern Judicial District of Texas, Houston, TX[1]

[1]Contact with these organizations was by written correspondence and/or telephone conversation only.

Sampling and Data Analysis Methodology

As part of our review, we collected data on the law enforcement and tax administration results of sampled SEP cases closed in fiscal years 1982 and 1985. Our sampling approach enabled us to project sample estimates to the universe of SEP cases closed nationwide during fiscal years 1982 and 1985. This appendix describes how we selected our sample and gives sampling errors for the estimates in our report.

Sample Selection and Scope

We used a stratified two-stage cluster sample to select 344 SEP cases closed during fiscal year 1982 and 376 SEP cases closed during 1985 from a total of 2,100 SEP cases closed during 1982 and 2,364 SEP cases closed during fiscal year 1985. We considered a SEP case to be closed when all CID investigative work was completed and a criminal outcome was known (for example, the case was declined for prosecution). This sampling design was the most efficient approach to meeting the objectives of the study with the resources available.

In selecting the sample, we began by dividing the IRS' 63 district offices into two groups, or strata. We placed three district offices—Manhattan, NY, Jacksonville, FL, and Chicago, IL—with high volumes of SEP cases closed in fiscal years 1982 and 1985 in the first group, and the remaining 60 district offices in the second group. We selected each of the 3 district offices from the first group for the sample; we selected 5 of the 60 district offices from the second group with the probability of selection for the sample proportional to the number of SEP cases closed in fiscal year 1982. We took a simple random sample of cases from each of the three district offices in the first group and all cases from the five district offices in the second group for each fiscal year. Table II.1 shows the total and sampled number of SEP cases closed in the sampled district offices and nationwide for fiscal years 1982 and 1985.

Table II.1: Total and Sampled Cases Closed in Sampled Districts and Nationwide for Fiscal Years 1982 and 1985

	Fiscal year 1982		Fiscal year 1985	
District office	**Total**	**Sample**	**Total**	**Sample**
Manhattan, NY	252	75	135	60
Jacksonville, FL	141	60	221	75
Chicago, IL	105	60	119	60
Buffalo, NY	33	33	46	46
Providence, RI	24	24	21	21
Atlanta, GA	34	34	42	42
St. Louis, MO	49	49	58	58
Wichita, KS	9	9	14	14
Nationwide total	**2,100**	**344**	**2,364**	**376**

We dropped two cases from the fiscal year 1982 sample and one case from the fiscal year 1985 sample because they did not meet the criteria for the sample.

Sampling Errors for Special Enforcement Program Data

The sampling errors for universe estimates vary by year and by characteristic being estimated. All sampling errors are reported at the 95 percent confidence level.

The sampling errors for all percentage estimates are 4 percent or less except for two estimates in table 2.3: the referral of fiscal year 1985 nongrand jury prosecuted cases (4.5 percent), and the referral of fiscal year 1985 nongrand jury, not prosecuted cases (5.2 percent). The sampling errors for the numbers shown in tables 2.2 and 2.3 are 3 percent or less when the numbers are expressed as a percentage of the column totals. For example, in table 2.2, the 368 fiscal year 1982 multiagency cases involving major criminals are 54.3 percent of the 678 multiagency cases. The sampling error for the 54.3 percent estimate is 0.9 percent, which gives a confidence interval of 53.4 percent to 55.2 percent.

The sampling errors for dollar estimates are approximately 10 percent or less of the estimate. For example, the sampling error for the $37.6 million estimate for the amount of taxes assessed is $1.2 million or 3.2 percent of the estimate. This gives a confidence interval of $36.4 million to $38.7 million (does not add due to rounding).

Table II.2 shows the upper and lower limits of the confidence intervals for key estimates from the Special Enforcement Program data.

Table II.2: Confidence Intervals for Key Universe Estimates

Dollars in millions

Description of Estimate	Estimate	Confidence interval (at 95% confidence) Lower limit	Upper limit
Percent of multiagency cases			
1982	32	32	33
1985	51	50	52
Percent of independent cases			
1982	60	60	61
1985	42	41	43
Percent of grand jury cases			
1982	42	41	43
1985	72	71	73
Percent of multiagency cases involving a grand jury			
1982	83	81	85
1985	93	91	95
Percent of independent cases involving a grand jury			
1982	16	16	17
1985	42	40	44
Percent of cases that resulted in a conviction			
1982	23	22	24
1985	47	46	48
Percent of multiagency cases that resulted in a conviction			
1982	29	27	31
1985	66	64	69
Percent of independent cases that resulted in a conviction			
1982	21	20	22
1985	30	29	31
Percent of convictions with no jail time for tax counts in 1985	32	31	33
Percent of convictions with no criminal fines for tax counts in 1985	58	55	60
Percent of cases involving a major criminal			
1982	31	30	31
1985	38	37	39
Percent of cases referred for tax assessment and collection			
1982	64	63	65
1985	55	54	56
Amount assessed in 1982	$37.6	$36.4	$38.7
Amount assessed on illegal source income in 1982	$6.3	$6.2	$6.3
Amount assessed on legal source income in 1982	$15.5	$14.5	$16.6
Amount assessed on income of undetermined source in 1982	$15.8	$14.8	$16.7
Amount collected in 1982	$11.2	$10.4	$11.9

(continued)

Description of Estimate	Confidence interval (at 95% confidence)		
	Estimate	Lower limit	Upper limit
Amount collected on illegal source income in 1982	$2.2	$2.2	$2.2
Amount collected on legal source income in 1982	$6.6	$5.8	$7.4
Amount collected on income of undetermined source in 1982	$2.3	$2.1	$2.6

Appendix III

Criminal Investigation Program Guidelines for Fiscal Year 1987

Exhibit 9100-2

Criminal Investigation Program Guidelines for Fiscal Year 1987

Purpose

This Exhibit provides FY 1987 program guidelines for the Criminal Investigation function.

Broad National Objectives

(1) The guidelines in this section represent broad national objectives.
  (a) National emphasis areas for the General Enforcement Program (GEP) are:
    1 Tax Shelter Program;
    2 Questionable Refund Program (QRP);
    3 Illegal Tax Protesters; and
    4 Other individuals whose illegal activities promote tax noncompliance.
  (b) National emphasis areas for the Special Enforcement Program (SEP) are:
    1 Task Forces on (1) Drug Traffickers and Organized Crime and the High-Level Drug Leaders Project and (2) the Southwest Border Initiative;
    2 Major organized crime figures and Strike Force targets; and
    3 Fraud and corruption in government and commercial bribery.
  (c) Emphasize investigations within both the GEP and SEP programs in which offshore banks, tax havens and money laundering are part of the evasion schemes.
  (d) Implement automated data systems for investigative and administrative purposes.
  (e) Continue to review and evaluate management decisions for the impact on the quality of service to taxpayers.
  (f) The continued development of a comprehensive Health Improvement Program for Special Agents.

(2) There will be a conscious commitment to the enhancement of quality in the Criminal Investigation work product. We will pursue and deserve a reputation of quality by providing reliable, timely, efficient, and economic service to the public. This will be achieved by:
  (a) Recognizing the importance of doing the job right the first time;
  (b) Establishing a quality climate where quality is first among equals with our other objectives;
  (c) Emphasizing product and service quality by eliminating systemic flaws during the planning, implementation, and operational processes;
  (d) Improving responsiveness to the public and other Service functions;
  (e) Instilling a quality spirit in every Criminal Investigation organization; and
  (f) Utilizing evaluative systems which are consistent with and reflective of the quality principles.

(3) Each district and region will develop its own program objectives (including their own quality initiatives), tailored to its respective long range compliance needs, in keeping with national emphasis areas. District program objectives will be consolidated into a Regional program letter which will be furnished to the Assistant Commissioner (CI) for concurrence.

Case Management

(1) *Case Development*—Identify areas of noncompliance and develop cases in those areas that are not detected by normal Collection, Examination, and Employee Plans and Exempt Organizations activities toward those areas of non-compliance not covered by referrals from other sources. The application of resources should be commensurate with the assessed potential of expected results.

(2) *Title 18 Violations*—Title 18 violations may be investigated if they are in contravention of the Internal Revenue.

(3) *Title 31 Violations*—Investigations of Title 31 Violations should be pursued in both the General and Special Enforcement Program areas, especially money laundering activities. Information available through the reporting requirements of Title 31 and information developed in Title 31 investigations should be used to develop and investigate Title 26 violations.

(4) *Case Selection/Investigations*—The focus will be to emphasize the use of criminal prosecution and publicize convictions as an effective deterrent. To assure this, districts should stress the need for quality case selection by:
  (a) Emphasizing the investigation of high impact cases in order to achieve voluntary compliance;
  (b) Adhering to the criteria for tax prosecution in Chapter 100 of LEM IX;
  (c) Emphasizing use of indirect methods of proof where taxable funds cannot be traced by specific items;
  (d) Employing special investigative techniques, when appropriate, e.g., undercover operations and electronic surveillance; and

Exhibit 9100-2 Cont.

Criminal Investigation Program Guidelines for Fiscal Year 1987 ◊

(e) Identifying investigations of organizations that cross district and regional boundaries and using "Key region" or similar concepts to coordinate these investigations (see IRM 9812). Utilize National Office of Investigations in these instances to further enhance and achieve cross-boundary cooperation.

(5) *Case Analysis*—Ensure adherence to OPM's Position Classification Standard for case assignments using the Criminal Investigation Case Analysis Guide procedures contained in text 314 of IRM 9783, Handbook for Criminal Investigation Group Managers.
(6) *Prompt Completion of Cases*—Ensure adherence to Policy Statement P-9-29 and IRM 9163 requiring the prompt completion of all criminal investigations in both GEP and SEP. Appropriate use of the team approach or multi-agent assignments should be emphasized to effectively complete complex cases.
(7) *Publicity*—In cooperation with the United States Attorney's office, seek to achieve the maximum deterrent publicity from criminal prosecutions and related actions.
(8) *Case Declinations*—Through use of advice and assistance of District Counsel during the course of the investigation when appropriate and stringent selection and review of cases, minimize declinations from all sources.
(9) *Case Management and Reporting*—Monitor investigative activities to assure adherence to prosecution criteria, program and project guidelines and to identify case defects. District management officials are responsible for accurate and timely Case Management and Time Reporting System submissions.

Position Management

Identify organizational forms or arrangements best suited to achieve specific work goals while maintaining cost-effective operations.

General Enforcement Program (GEP)

(1) Each region will strive to apply 50-60 percent of direct investigative time to GEP.
(2) Identify and investigate significant GEP cases in identified areas of noncompliance through quality referrals and information gathering efforts. To ensure increased quality of referrals, managers will maintain effective liaison with referring functions.

Special Enforcement Program (SEP)

(1) Each region will strive to apply 40-50 percent of direct investigative time to SEP. This includes the resources committed to OCDETF and the Southwest Border Initiative.
(2) Identify and investigate significant SEP cases to achieve maximum impact and compliance effect. Investigations in SEP should emphasize increased activity in inter-agency efforts through assistance in appropriate grand juries and effective liaison between Service offices, DOJ and other enforcement agencies.
(3) Direct emphasis in SEP toward major narcotics and organized crime elements.

Agency Comments

COMMISSIONER

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

MAR 1 1988

Mr. Richard L. Fogel
Assistant Comptroller General
General Accounting Office
Washington, DC 20548

Dear Mr. Fogel:

We have reviewed your recent draft report entitled "Tax Administration: Investigating Illegal Income--Success Uncertain, Improvements Needed" and have enclosed detailed comments on the report recommendations.

We hope you find these comments useful.

With kind regards,

Sincerely,

Enclosure

IRS COMMENTS ON RECOMMENDATIONS
CONTAINED IN GAO DRAFT REPORT ENTITLED
"TAX ADMINISTRATION: INVESTIGATING ILLEGAL INCOME--
SUCCESS UNCERTAIN, IMPROVEMENTS NEEDED"

Recommendation 1:

Collect management information relating to key program objectives such as investigating major criminals and referring closed cases for tax assessment or collection. Also, identify the tax revenues generated by SEP cases.

Comment:

Now on p. 24.

We concur with the findings noted on page 36 that our present Criminal Investigation Case Management and Time Reporting System (CM&TRS) does not provide information to indicate that a case involved a major criminal or widespread publicity, nor information on subsequent civil actions. We agree that such information should improve our ability to monitor program objectives. Top level officials within Criminal Investigation are analyzing the CM&TRS and will make recommendations on how to improve this system to more accurately reflect our efforts.

With respect to identifying tax revenues generated by SEP cases, we have a task force studying this matter in the Southeast Region. Our response to Recommendation #4 discusses the task force in more detail.

Recommendation 2:

Review existing CM&TRS input controls to determine how the accuracy of management information can be improved.

Comment:

We concur with this recommendation. The accuracy of CM&TRS is a priority objective of Criminal Investigation. Future regional and National Office visitations will include a review of district and region policies and procedures regarding CM&TRS data accuracy and controls. The study group discussed in our response to Recommendation #1 is also reviewing the quality and accuracy of data in the CM&TRS. The lack of accurate data in our CM&TRS was discussed at our District Office Criminal Investigation Division Chief's meeting in January 1988. At this meeting it was stressed that the accuracy of CM&TRS will be a priority issue in all operations reviews conducted by the Chiefs.

Recommendation 3:

Work with IRS Chief Counsel and Department of Justice representatives to provide better guidance for special agents on what constitutes grand jury information. Also, require special agents to consult with IRS Chief Counsel attorneys, or with U.S. Attorney representatives if IRS Chief Counsel is not involved, at the close of a grand jury case to help determine what information could be forwarded to Examination for civil action.

Comment:

We concur that, in grand jury matters, special agents should confer with the appropriate U.S. Attorney to insure that all information applicable for civil purposes is made available to Examination personnel. We will incorporate this into Part IX of the Internal Revenue Manual in the near future.

The Office of Chief Counsel is also currently completely revising its Chief Counsel Directive Manual in this area as part of a coordinated effort with the Department of Justice and the IRS's field Criminal Tax attorneys. Guidelines issued by IRS must be consistent with the position of the Department of Justice for the Goverment as a whole.

We agree with the premise that better guidelines for working with grand jury information could increase referrals for tax assessments. However, the definition of what constitutes grand jury material is unclear and has resulted in conflicting judicial decisions. For example, the Seventh and District of Columbia Circuits have reached opposite conclusions on similar facts (Matter of Special March 1981 Grand Jury, 753 F.2d 575, 7th Cir. 1985, conflicts with In Re Sealed Case, 801 F.2d 1379, D.C. Cir. 1986). This, in turn, makes the development of comprehensive guidelines a difficult task.

Soon after the Supreme Court rendered its opinions in Baggot and Sells, the Department of Justice promulgated guidelines (dated January 1984). Those guidelines address many of the issues in this area of law and contain a discussion of what constitutes a matter occurring before the grand jury. While the guidelines are three years old, little definitive law has developed since the guidelines were promulgated.

-3-

Meanwhile during this period, the IRS has (1) updated its Chief Counsel Directive Manual (CCDM) to reflect the impact of Baggot and Sells and other definitive law in the area; (2) issued memoranda each time a court opinion is rendered in this area; (3) invited agents to seek Counsel advice in the formal closing memorandum for each criminal case; (4) directed that Counsel responses to agents be coordinated with the relevant National Office Division; and, (5) offered numerous informal training sessions in this area, as well as making the subject a mandatory topic for the annual Continuing Legal Education program.

As you can see the area has received much attention. The consistent message to all agents has been to seek Counsel guidance, and from within Counsel, to coordinate responses. The two initiatives mentioned earlier should strengthen that message.

Recommendation 4:

Establish a district office program to monitor the civil actions taken by various IRS components on closed criminal cases.

Comment:

The recommendation to establish a district program to monitor civil actions on closed criminal cases has a good deal of merit. The Birmingham Plan appears to have been successful. When the Southeast Region task force completes its feasibility study of both the Birmingham District and Jacksonville District civil action plans, an informed decision to implement this or a similar plan will be made.

*U.S. G.P.O. 1988-201-749:80068

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